Supreme Court, U.S.
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Nos. 13-1421, 14-163

IN THE

Supreme Court of the United States

BANK OF AMERICA, N.A.,

Petitioner,

v.

DAVID B. CAULKETT,

Respondent.

BANK OF AMERICA, N.A.,

Petitioner,

v.

EDELMIRO TOLEDO-CARDONA,

Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

BRIEF OF *AMICUS CURIAE* NYU LAW SCHOOL BANKRUPTCY APPELLATE CLINIC IN SUPPORT OF RESPONDENTS

Arthur J. Gonzalez
Counsel of Record
NEW YORK UNIVERSITY SCHOOL OF LAW
40 Washington Square South, 314A
New York, NY 10012
(212) 998-6231
arthur.gonzalez@nyu.edu

Counsel for Amicus Curiae

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INTEREST OF THE *AMICUS CURIAE*[1]

The undersigned *amicus curiae* is the New York University School of Law Bankruptcy Appellate Clinic. The undersigned Arthur J. Gonzalez, counsel of record for the clinic, is a Senior Fellow at the NYU School of Law, a former judge of the United States Bankruptcy Court for the Southern District of New York, and one of the instructors of the clinic. The undersigned and the participants in the clinic are deeply interested in bankruptcy law, including the issues presented in this case.

The purpose of this brief is to address important matters that bear on the resolution of the issues that arise in this case. These include examination of not only the text of section 506, its context within the Bankruptcy Code, and its

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[1] No counsel for any party has authored this brief in whole or in part, and no party or counsel for a party has made a monetary contribution to the preparation or submission of this brief. *See* Sup. Ct. R. 37.6. All parties have been timely notified of the undersigned's intent to file this brief; both Petitioner and Respondents have consented to the filing of this brief in these consolidated cases. Respondents have filed with the Court a letter consenting to the filing of *amicus curiae* briefs in support of either or neither party. A copy of Petitioner's consent is filed herewith.

relevant history, but also the larger policies of the Code and the Court's interpretative canons long applied in cases of this kind. It is anticipated that, in particular, the discussion of the role that section 506 plays in disencumbering overly leveraged assets in bankruptcy is not one addressed in detail by other participants in this proceeding.

STATEMENT

In 2006, David Caulkett (Caulkett) purchased the home in which he and his wife currently reside for $249,500. Opp. at 5. Caulkett financed the purchase with two mortgage loans, granting a first mortgage lien to secure a "senior" loan in the amount of $199,600, and a second or "junior" mortgage lien to secure a second loan of $49,900. *Id.* Caulkett made payments on both of these loans until May of 2013, when he filed for bankruptcy in the U.S. Bankruptcy Court for the Middle District of Florida. *Id.* at 6.

Caulkett's primary asset is the home. Resp't's Bankr. Pet. at 6. At the time of the commencement of his bankruptcy case in 2013, the value of the property had declined to approximately $98,000, a fraction of its 2006 purchase price. Opp. at 6. The debts secured by the first and second mortgage liens, however, have declined more modestly—the first loan, held by Seterus, Inc., stands at about $183,264 and the

second loan, held by Bank of America, at $47,855. *Id.*

By its terms, a junior mortgage is exactly what the term suggests—second in priority to the first mortgage. *See* Fred E. Case, *The Use of Junior Mortgages in Real Estate Financing*, 10 J. Fin. 41, 42 (1955). This means that if there is not enough value in the home to satisfy the first mortgage in, for example, a foreclosure proceeding, the junior mortgagee is entitled to nothing from the collateral and its lien is deemed, in the vernacular, to be "wholly underwater." In general, institutions that take junior mortgages charge higher interest rates on their loans than those that take first-priority mortgages to compensate for the risk that there might not be sufficient value in the collateral to cover their loans.

Although the holders of junior mortgage liens may find themselves deeply "underwater," this does not mean that they lack leverage against debtors such as Caulkett and competing senior mortgage holders. For example, even though their liens may be ostensibly worthless, junior lienholders may still threaten to place overly encumbered properties into foreclosure, or thwart market-price "short sales" approved by senior lenders, by refusing to consent to the release of their underwater junior liens unless they receive payment of some kind. *See* Prashant Gopal and John Gittelsohn, *Home Sales Held Hos-*

tage by Junior Lien Holders: Mortgages, Bloomberg Business Week (July 23, 2012), http://www.bloomberg.com/news/articles/2012-07-23/home-sales-held-hostage-by-junior-lien-holders-mortgages.[2] In other words, the holders of junior mortgages have certain "hold out" powers, the exercise of which may force properties that might otherwise be sold in successful short-sale transactions into foreclosure, which in turn may encourage home abandonment.[3]

In order to avoid foreclosure and retain his home, Caulkett stated his intention to reaffirm the primary loan held by the first-priority mortgagee. Resp't's Bankr. Pet. at 35. Because the amount of the first mortgage vastly exceeds the value of the home, however, Caulkett is unwilling to assume the first mortgage loan unless he

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[2] The term "short sale" refers to a sale of real property that does not generate sufficient proceeds to pay off in full applicable mortgage loans encumbering the property. *See* 1 Baxter Dunaway, *Law of Distressed Real Estate* § 3B:8 (2008).

[3] *See, e.g.*, Brendan Buschman, *Why Not Strip to Save Your Home? Prohibition on Chapter 7 Strip Off Makes No Cents for Debtors or Creditors*, 22 J.L. & Pol'y 267, 295-96 (2013) (explaining how the preservation of unsecured junior liens incentivizes home abandonment and citing to the parallel discussion from *Folendore v. United States Small Business Administration (In re Folendore)*, 862 F.2d 1537, 1540 (11th Cir. 1989)).

can "strip off" the worthless second mortgage lien.[4]

On December 11, 2013, the bankruptcy court granted Caulkett's motion to determine that Bank of America holds an entirely unsecured claim and to strip off the junior lien under Bankruptcy Code section 506(d). Order, Dec. 11, 2013; Pet. App. 5a. In the proceedings in the bankruptcy court, Bank of America did not dispute the value of the home. Tr. 3:22-23, Dec. 5, 2013 ("Your Honor, we're not challenging the value of the property"); Reply at 1. Nor did it dispute that, if the home were foreclosed, it would receive nothing from a foreclosure sale. The bank simply challenged whether the strip off of its lien is permissible in bankruptcy. On appeal, both the district court and the Eleventh Circuit affirmed the bankruptcy court's order, citing prior circuit precedent. *Bank of Am., N.A. v. Caulkett*, No. 6:14-CV-78-ORL-31, 2014 WL 7175386 (M.D. Fla. Feb. 14, 2014), *aff'd sub nom. In re Caulkett*, 566 F. App'x 879 (11th Cir. 2014).

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[4] Because there is no value to the junior mortgage, Caulkett's debt obligation to Bank of America is unsecured. Accordingly, Caulkett's personal debt to the bank may be discharged in his bankruptcy case as an unsecured liability. 11 U.S.C. §§ 523, 524, 727. The question presented here is whether, notwithstanding the discharge of Caulkett's personal liability to the bank, the bank may keep its lien on the home in order to attempt to collect payment in the future on the basis of its retained lien.

On November 17, 2014, this Court granted certiorari review.

Amicus notes that this case has been consolidated with *Bank of America v. Toledo-Cardona*, no. 14-163. Because the issues in both cases are the same, and because the facts of this case fairly represent how the issues arise generally, *Amicus* does not address separately the facts of *Toledo-Cardona* or refer to them in this brief.

SUMMARY OF THE ARGUMENT

With two exceptions not relevant here, section 506(d) directs: "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void." As Justice Scalia observed in his dissent in *Dewsnup v. Timm*, 502 U.S. 410, 420 (1992), whether a particular lien securing a claim is voidable in whole or in part under this provision (i.e., may be "stripped down" to the value of the collateral, or "stripped off" because there is no value in the collateral available to secure the claim) depends on the meaning of the phrase "allowed secured claim." Section 506(a) provides a textual definition:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest
>
> is a secured claim to the extent

> of the value of such creditor's interest in the estate's interest in such property . . and is an unsecured claim to the extent that the value of such creditor's interest . is less than the amount of such allowed claim.

By its terms, section 506(a) commands that, even though an allowed claim may be secured by a lien, the claim is to be treated as wholly *unsecured* to the extent that there is no value in the collateral available to satisfy the creditor's lien at the time of the debtor's bankruptcy. In this case, that perfectly describes Bank of America's junior lien—the value of Caulkett's home is not sufficient to cover the claim of the first mortgagee, leaving no value for Bank of America's junior interest in the collateral. Thus, under section 506(a), Bank of America holds an entirely *un*secured claim, just as the bankruptcy court determined. For purposes of section 506(d), allowed *un*secured claims are obviously not "allowed secured claims" because they are *un*secured. Because the bank's claim is entirely unsecured, there is no warrant in section 506(d) to treat it as secured in any respect, and its lien is thus properly void, as the bankruptcy court held.

Notably, section 506 does not preserve a lien holder's "rights." Elsewhere in the Code, when Congress intended to preserve a lien holder's "rights" in some way (as distinct from its secured

"claim" or the value of its interest in property of the debtor) Congress expressly so provided. *See, e.g.*, 11 U.S.C. § 1322(b)(2) (permitting the modification of the "rights" of the holders of secured claims, other than those secured only by a security interest in the debtor's principal residence). Section 506, however, works differently. As is relevant here, section 506 operates to recognize and preserve liens only to the extent of any *value* in the relevant collateral available to satisfy the claim. Although Bank of America would like to have its non-bankruptcy "rights" preserved, the status of a secured claim (and its associated lien) under section 506 turns on the collateral's "value," not the fact that the bank has lien rights. Where, as here, there is no value to the junior lien under section 506(a), the secured creditor's claim is not "secured" in any respect and the accompanying lien is thus entirely void.

The Court's decision in *Dewsnup* is not to the contrary. *Dewsnup* involved a partially secured claim. Although the value of the collateral in that case was less than the full amount of the relevant debt, nonetheless there was substantial value to the secured creditor's lien interest. In *Dewsnup*, the Court determined that the phrase "allowed secured claim" in section 506(d) encompasses both fully and partially secured claims, stating that the phrase "allowed secured claim" is to be "read term-by-term to refer to any claim that is, first, allowed, and, second, secured." 502

U.S. at 415. Because there was at least some value to the secured creditor's lien interest in *Dewsnup*, the Court concluded that voiding the lien to the extent of any value shortfall would be inappropriate. *Id.* at 417. At the same time, however, the Court was careful to limit its analysis to the precise facts. *Id.* at 416–17 ("We therefore focus upon the case before us and allow other facts to await their legal resolution on another day."). Critically, nothing in *Dewsnup* or section 506 requires or permits the preservation of an entirely valueless lien securing a wholly *un*secured claim. Indeed, the plain command of the statute is to the contrary: the lien is void under section 506(d).

In seeking the preservation of its lien notwithstanding the absence of any value supporting it, Bank of America seeks a priority position contrary to not only the plain text of the Bankruptcy Code but also its fundamental policies. First, the bank's position is at odds with the policy of equality of distribution among creditors. The Code differentiates starkly between secured and unsecured claims. The former are granted priority treatment and a variety of special protections; the latter are not, and generally unsecured claims must share-and-share-alike from often meager distributions from the debtor's bankruptcy estate. By seeking to retain its valueless lien, Bank of America hopes to gain an advantage other unsecured creditors do not en-

joy—the potential right in the future to demand payment from the debtor if, for example, the debtor ever seeks to sell the collateral voluntarily to pay off the first mortgage lien (in which case the bank may demand some payment as the price of its consent to the release of its lien in order to permit the voluntary sale). Because priority provisions in bankruptcy should be tightly construed, Bank of America's interpretation of the statute seeking a priority the text does not state should be rejected.

Second, Bank of America's position is at odds with the Code's fresh-start policy. Although the bank's lien is currently worthless, preserving it would vest the bank with a potent future debt-collection tool it could use to extract payment from the debtor down the road in a variety of contexts. Indeed, that is the only conceivable reason why the bank seeks to retain its lien—to gain some monetary future benefit notwithstanding the current worthlessness of its lien and the dischargeability of its unsecured claim for the amount of its loan. 11 U.S.C. § 727. Because exceptions to the debtor's discharge and the provisions of the Code that support it should be limited to those plainly stated, Bank of America's interpretation of the statute once again should be rejected.

Third, Bank of America's position is at odds with the Code's policy of deleveraging over-

encumbered assets, not only in the reorganization context, but also in liquidation proceedings. Assets that are over-encumbered by worthless liens burden not only the debtor, other creditors, and the bankruptcy estate, but also the marketplace, often necessitating expensive and inefficient state-law foreclosure proceedings that bankruptcy was designed to avoid. Various provisions of the Code operate to deleverage over-encumbered assets so that they may be freed of excessive indebtedness and accompanying liens in order that these assets may be put to productive use short of resort to cumbersome and inefficient state-law foreclosures. *See, e.g.*, 11 U.S.C. § 363(f) (allowing for the sale of property free and clear of liens and other encumbrances). Section 506(d) is one of these provisions. Bank of America, of course, wishes to accomplish precisely the opposite result that these provisions command: to continue to over-encumber the debtor's home for its own financial gain. Because Bank of America's position is fundamentally contrary to the salient bankruptcy policy of disentangling assets from excessive indebtedness, its interpretation of the statute should be rejected.

ARGUMENT

A. Bank of America's Interpretation of Section 506 Is Contrary to Its Text, Context, and History, and the Bank's Reliance on *Dewsnup* Is Misplaced.

1. The Bank's Construction of the Statute Is Contrary to Its Text, Context, and History.

In construing and applying the Bankruptcy Code, "[t]he starting point . is the existing statutory text." *Lamie v. United States Trustee*, 540 U.S. 526, 534 (2004). In addition, "when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (internal quotation marks omitted); *see also Rake v. Wade*, 508 U.S. 464, 471 (1993); *Connecticut Nat'l Bank v. Germain*, 503 U.S. 249, 253-54 (1992). Likewise, the provisions of a statute should be construed together holistically, and not in a disjointed, piecemeal fashion. *See United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 369-71 (1988) (construing several sections of the Bankruptcy Code together and observing that "[s]tatutory construction is a holistic endeavor"); *Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sen-

tence or member of a sentence, but look to the provisions of the whole law ") (citations omitted); *Richards v. United States*, 369 U.S. 1, 11 (1962) ("We believe it fundamental that a section of a statute should not be read in isolation from the context of the whole Act ."). Moreover, they should be construed to avoid rendering any part superfluous. *See, e.g., Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998) ("[W]e are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law." (citation omitted)); *Montclair v. Ramsdell*, 107 U.S. 147, 152 (1883) ("It is the duty of the court to give effect, if possible, to every clause and word of a statute "). In this case, Bank of America's interpretation of section 506 violates all of these principles and is fundamentally unsound.

By its plain terms, section 506(a) acts to sort an "allowed claim" into (1) an "allowed secured claim to the extent of the value of such creditor's interest in the estate's interest in such property" and (2) an "unsecured claim to the extent that the value of such creditor's interest is less than the amount of such allowed claim." 11 U.S.C. § 506(a).[5] Put differently, sec-

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[5] The term "claim" is defined in section 101 of the Code to include a broad assortment of rights to payment, and plainly encompasses the bank's claim in this case. 11 U.S.C. § 101(5). An "allowed" claim is the functional re-

tion 506(a) operates to bifurcate claims accompanied by liens into secured and unsecured portions based upon a judicial valuation of the underlying collateral. *See Nobelman, v. Am. Sav. Bank*, 508 U.S. 324, 328 (1993); *see also Associates Commercial v. Rash*, 520 U.S. 953, 961 (1997) ("[A] secured creditor's claim is to be divided into secured and unsecured portions" and "[t]o separate the secured from the unsecured portion of a claim, a court must compare the creditor's claim to the value of the collateral."); *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 239 (1989) ("Subsection (a) of § 506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured.").[6] Here, Bank of America's claim is wholly unsecured under section 506(a) because the current monetary value of its lien interest in the debtor's home is zero.

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sult of a claim that has been allowed under the provisions of section 502 of the Code. 11 U.S.C. § 502.

[6] In these and other cases, the Court has recognized a secured creditor's entitlement under the Code to be limited to "the value of its property rights, as measured by the value of its collateral, and not to the *in rem* rights themselves." Margaret Howard, *Secured Claims in Bankruptcy: An Essay on Missing the Point*, 23 Cap. U. L. Rev. 313, 313 (1994).

In turn, section 506(d) makes use of the phrase "allowed secured claim" in avoiding worthless liens, stating that "[t]o the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void[.]" 11 U.S.C. § 506(d). The most natural and best reading of subsection (d) is that a creditor's lien is void when its claim is determined (as in this case) to be an "unsecured claim" under subsection (a). This follows not only from the relevant text, but also from examination of the Code as a whole and its relevant legislative history, all of which confirm that Congress intended the phrase "allowed secured claim" used in section 506(d) to have the meaning set forth in section 506(a) and to exclude wholly unsecured claims.

The frequent and consistent pattern of Congress's use of the term "allowed secured claim" throughout the Code indicates that the phrase was intended to be used consistently wherever it appears. The phrase is used in numerous sections of the Code. *See* 11 U.S.C. §§ 348, 506, 524, 722, 724, 1222, 1225, 1325. Moreover, a survey of the usage of the phrase shows that "allowed secured claim" operates throughout the Code in order to achieve particular results that depend upon a consistent meaning—namely the meaning set forth in section 506(a). *Dewsnup*, 502 U.S. *at* 421-22 (Scalia, J., dissenting) (reviewing sections of the Code that use the phrase "allowed secured claim" to reflect the bifurcation process

of subsection 506(a) in 11 U.S.C. §§ 722, 1225(a)(5), 1325(a)(5)).

Likewise, it is clear from the legislative history that Congress intended the phrase "secured claim" to be interpreted consistently as prescribed in section 506(a). As explained in the relevant House Report accompanying the Code, "[t]hroughout the bill, references to secured claims are only to the claim determined to be secured under this subsection [i.e., subsection (a)], and not to the full amount of the creditor's claim." H.R. Rep. No. 95-595, at 356 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6312; *see In re Jones*, 152 B.R. 155, 163 (Bankr. E.D. Mich. 1993) (citing legislative history). Review of the Code and its legislative history thus confirms that there is no warrant for the notion that the phrase "allowed secured claim" appearing in section 506(d) somehow permits the preservation of a lien accompanying a claim that is wholly *un*secured under the provisions of section 506(a). In context, the import of the term "secured claim" appearing in section 506(d) directs that, in order to be spared from voidness, a lien accompanying a claim must have at least some value as determined in accordance with section 506(a). Bank of America's contrary argument is unsound because, among other flaws, it effectively reads the word "secured" out of section 506(d) by (at the very least) striving to give it an utterly idiosyncratic meaning divorced from the actual context in which it appears.

If Congress had intended to preserve a creditor's *in rem* lien "rights" accompanying a particular claim notwithstanding the provisions of section 506(d), Congress could easily have done so. For example, using different terms, section 1322(b)(2) (applicable in Chapter 13 cases) permits the modification of the "rights" of the holders of secured claims, *except* those accompanying claims secured only by a lien on the debtor's principal residence. 11 U.S.C. § 1322(b)(2). As the Court observed in *Nobelman*, the specially worded language of section 1322(b)(2) protects the holders of both fully and partially secured claims from lien modification. 508 U.S. at 325-26. *Nobelman* itself, however, strongly suggested that if a claim is completely unsecured, there should be a different result. *See* 8 Collier on Bankruptcy ¶ 1322.06[1][a][i] (15th ed. rev. 2001). Consequently, in Chapter 13 cases, the Code does not preserve lien rights associated with wholly *un*secured claims, and the strip-off of valueless liens is common practice.[7]

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[7] *See Lane v. Western Interstate Bancorp (In re Lane)*, 280 F.3d 663, 668 (6th Cir. 2002) ("[T]he dividing line drawn by § 1322(b)(2) runs between the lienholder whose security interest in the homestead property has some 'value' and the lienholder [who does not]."); *Zimmer v. PSB Lending Corp. (In re Zimmer)*, 313 F.3d 1220 (9th Cir. 2002); *Pond v. Farm Specialist Realty (In re Pond)*, 252 F.3d 122 (2d Cir. 2001); *Tanner v. FirstPlus Fin., Inc. (In re Tanner)*, 217 F.3d 1357 (11th Cir. 2000); *Bartee v. Tara*

If Congress had intended to preserve the lien "rights" of the holders of entirely unsecured claims in Chapter 7 notwithstanding the directive of section 506(d) that liens accompanying claims that are not "allowed secured claims" are void, it could easily have done so. The fact that it did not do so—and indeed used a different series of terms in section 506(d) focusing on value as compared to the "rights" of creditors—illustrates that Congress did not intend the meaning that Bank of America ascribes to section 506. *See Russello v. United States*, 464 U.S. 16, 23 (1983) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.") (citation omitted). The bank's erroneous interpretation of the statute should be rejected.

Colony Homeowners Ass'n (In re Bartee), 212 F.3d 277 (5th Cir. 2000); *McDonald v. Master Fin., Inc. (In re McDonald)*, 205 F.3d 606 (3d Cir. 2000); *Domestic Bank v. Mann (In re Mann)*, 249 B.R. 831 (B.A.P. 1st Cir. 2000); *Lam v. Investors Thrift (In re Lam)*, 211 B.R. 36 (B.A.P. 9th Cir. 1997).

2. The Bank's Reliance on *Dewsnup* Is Unsound.

The Court's decision in *Dewsnup* does not compel a different outcome. To begin with, the facts of *Dewsnup* are distinct. There, the dispute involved a single secured creditor holding a partially secured claim against the debtor, and the property in question was headed for foreclosure. *Dewsnup*, 502 U.S. at 412. Here, the dispute involves a wholly unsecured junior creditor seeking to burden the debtor's retention of his home, as well as the debtor's intention of paying the senior secured lender, by seeking to preserve its entirely valueless junior lien. Regardless of whether there is any ambiguity in section 506(d) in the context of its application to a partially secured claim (as in *Dewsnup*), there is no ambiguity in the context of a claim like Petitioner's that is entirely *un*secured. Under no reasonable stretch of the imagination can the phrase "allowed secured claim" be taken to shelter a claim that is entirely *un*secured within the meaning of section 506(a).

Upon closer examination, the Court's various concerns with lien-stripping outlined in *Dewsnup* do not actually favor the bank. Citing the principle that "[w]hen Congress amends the bankruptcy laws, it does not write on a clean slate," *Dewsnup*, 502 U.S. at 419 (citations omitted) (internal quotation marks omitted), the Court in *Dewsnup* observed that, as a general historical matter, liens often passed through

bankruptcy unaffected, *id.* at 418. But in its current form the Code departs significantly from this historic norm and, in fact, the idea that "liens pass through bankruptcy" is now much more the exception rather than the rule.

As the Court observed in *United States v. Ron Pair Enterprises, Inc.* (in which it was called upon to interpret a different provision of section 506), the enactment of the Bankruptcy Code "was intended to modernize the bankruptcy laws, and as a result made significant changes in both the substantive and procedural laws of bankruptcy." 489 U.S. 235, 240 (1989) (citation omitted). And as is particularly relevant here, "Congress intended significant changes [in] the treatment of secured creditors and secured claims." *Id.* (citations omitted) (internal quotation marks omitted). Critically, one of those changes was to abrogate in many respects the idea that liens pass through bankruptcy unaffected.

As explained in the legislative history, section 506—which had no direct antecedent in the former Bankruptcy Act of 1898—"abolishes the use of the terms 'secured creditor' and 'unsecured creditor' and substitutes in their place the terms 'secured claim' and 'unsecured claim.'" H.R. REP. No. 95-595, at 356, *reprinted in* 1978 U.S.C.C.A.N. 5963, 6312. Moreover, as the legislative history makes clear:

> The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are under-secured. Current law is ambiguous and vague, especially under Chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that [a partially secured] creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.

Id. at 180-81. What this makes plain is that the focus of section 506 is, first, on claims, not rights. Second, the focus is on the "value" of the collateral, not the existence of the lien. Where, as here, there is no value to the particular lien, the claim must be treated as wholly *un*secured and, by operation of section 506(d), the accompanying lien is void.

The Bankruptcy Code ushered in many changes that altered pre-Code practice, including various provisions directing the modification of

secured claims and accompanying liens. For example, lien stripping is permitted in Chapter 11 reorganization cases under section 1129(b)(2), in Chapter 12 cases under section 1225(a)(5), and, as noted, in Chapter 13 cases under section 1322(b)(2). 11 U.S.C. §§ 1129(b)(2), 1225(a)(5), 1322(b)(2). Moreover, in Chapter 7 cases section 506(d) is not the only provision that authorizes Bankruptcy Courts to void liens. For example, contrary to the historic concept that "liens pass through bankruptcy unaffected," certain liens may be voided to the extent they impair a debtor's exemptions, *see* 11 U.S.C. § 522(f), or if they constitute preferences or fraudulent transfers, *see* 11 U.S.C. §§ 547-548. In truth, the new norm in bankruptcy is that, generally speaking, liens often *do not* pass through bankruptcy unaffected.

In *Dewsnup*, the Court was concerned that the debtor might have received a "windfall" if permitted to strip down the creditor's lien to a judicially determined value on the facts presented. In an effort to prevent the debtor from realizing value for herself in the event that the foreclosure value of the property rose above its judicially determined value, the Court reasoned that the creditor's lien should stay with the property unmodified until the foreclosure process was complete. 502 U.S. at 417. But the opposite concern arises when, as here, the junior mortgagee's claim is completely unsecured. By seeking to retain its worthless junior lien, it is the junior mortgagee who seeks a "windfall" in the form of

the power to potentially extract value from the *senior* lien holder in, for example, the short sale context, inverting the priority scheme. The junior mortgagee also seeks the "windfall" of potentially extracting value from the debtor's future earnings, which creditors generally cannot reach in Chapter 7 cases. Fair enough, the debtor may have to pay something for the home in order to keep it out of bankruptcy. But the debtor should not have to pay *more* than the home is worth to the first mortgagee, *and then* still more to the second mortgagee with the entirely worthless junior claim. Nothing in section 506 (or general concepts of equity) supports that result.

In *Dewsnup*, the Court also expressed concern that the retrospective application of the then-novel section 506(d) to strip down the secured creditor's mortgage might have generated a Fifth Amendment problem. 502 U.S. at 419. But whereas the *Dewsnup* mortgage pre-dated the enactment of the Code (thus giving rise to a possible problem if applied retroactively), Bank of America's mortgage loan obviously does not. Moreover, depriving a junior mortgagee of a wholly valueless lien simply cannot constitute an unconstitutional taking: the government is neither required to compensate for value where none exists nor where its intervention is, in the form of some ameliorative scheme like bankruptcy law, what offers the possibility of value that otherwise would not be there (e.g., by the avoidance of value-destroying foreclosure). *See Phil-*

lips v. Washington Legal Found., 524 U.S. 156, 181 (1998) ("And whatever this Court's cases may have said about the constitutional status of such a right, they have *not* said that the Constitution forces a State to confer, upon the owner of property that cannot produce anything of value for him, ownership of the fruits of that property should that property be rendered fertile through the government's lawful intervention." (emphasis in original)). In sum, *Deswnup* is inapposite here and does not genuinely support, let alone compel, the conclusion that a wholly unsecured claim such as the one held by the bank in this case should be treated as an allowed secured claim for purposes of section 506(d).

B. The Bank's Interpretation of Section 506 Is Contrary to the Major Policies of the Bankruptcy Code.

In expounding the meaning of a statute, courts properly look "not only to the particular statutory language, but [also] to the design of the statute as a whole and to its object and policy." *Dada v. Mukasey*, 554 U.S. 1, 16 (2008) (*quoting Gozlon-Peretz v. United States*, 498 U.S. 395, 407 (1991)); *see also Kelly v. Robinson*, 479 U.S. 36, 43 (1986) ("In expounding a statute, we must not be guided by a single sentence but look to the provisions of the whole law, and to its object and policy." (citation omitted)). In this case, Bank of America's position is contrary not only to the text, context, and history of section 506, but also

to several important bankruptcy policies. For this reason as well, the bank's argument is unsound.

1. The Bank's Approach Contravenes the Policy of Equality of Treatment Among Creditors.

As the Court has long recognized, one of the fundamental policies of the Bankruptcy Code is the concept of equality of distribution among creditors. *See, e.g.*, *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (discussing "the prime bankruptcy policy of equality of distribution" to creditors); *Young v. Higbee Co.*, 324 U.S. 204, 210 (1945) ("[H]istorically one of the prime purposes of the bankruptcy law has been to bring about a ratable distribution among creditors of a bankrupt's assets "); *Buchanan v. Smith*, 83 U.S. 277, 301 (1872) (noting the main bankruptcy policy of "[e]qual distribution of the property of the bankrupt, *pro rata*"). Because Bank of America holds an entirely unsecured claim, the lot of the general unsecured creditor is all that it is entitled to enjoy—unless, of course, some provision of the Code affirmatively grants it special treatment. *See, e.g.*, 11 U.S.C. § 507. No provision, however, does so in this instance, and the bank's effort to conjure up priority treatment for itself through its strained interpretation of section 506 should be rejected.

Because the priority treatment of a particular creditor's claim undermines the general policy of equality of distribution, the Court has long followed the principle that the Code's priority provisions should be construed narrowly, disfavoring priorities that are not clearly articulated. *See Howard Delivery Serv., Inc. v. Zurich American Ins. Co.*, 547 U.S. 651, 667 (2006). For example, relying specifically on the Code's aim "to secure equal distribution among creditors," the Court declined in *Howard Delivery* to afford priority status to premiums paid for workers' compensation insurance, even though these arguably fell within the reach of the priority provision in question. *Id.* at 655. The Court explained that the equal distribution objective produces the "corollary principle that provisions allowing preferences must be tightly construed." *Id.* at 667; *see also Nathanson v. NLRB*, 344 U.S. 25, 29 (1952) ("The theme of the Bankruptcy Act is 'equality of distribution' and if one claimant is to be preferred over others, the purpose should be clear from the statute." (quoting *Sampsell v. Imperial Paper & Color Corp.*, 313 U.S. 215, 219 (1941) (explaining that in light of the bankruptcy theme of equality of distribution "an unsecured creditor carries a burden of showing by clear and convincing evidence that its application to his case so as to deny him priority would work an injustice."))); *Kothe v. R.C. Taylor Trust*, 280 U.S. 224, 227 (1930) ("The broad purpose of the Bankruptcy Act is to bring about an equitable distri-

bution of the bankrupt's estate . [and] [a]ny agreement which tends to defeat that beneficent design must be regarded with disfavor."); 4 Collier on Bankruptcy ¶ 507.01 (16th ed. 2012) ("Because priorities grant special rights to the holders of priority claims, priorities under the Code are to be narrowly construed.").

Section 506 is a priority provision. It confers secured status on a claim to the extent the claim is accompanied by a lien and the lien has value as determined under the protocol in section 506(a). In challenging the decisions below, Bank of America offers a remarkably generous construction of section 506 that, if accepted, would clothe its entirely unsecured claim with at least some of the advantages of secured status, even though its claim does not qualify for secured treatment. That result is precisely the opposite of that directed by the Court in cases such as *Howard Delivery*. Because the bank's strained interpretation of the statute runs afoul of this longstanding approach and the salient bankruptcy policy it serves, it should be rejected.

2. The Bank's Approach Contravenes the Policy of Providing Honest but Unfortunate Debtors with a Fresh Start.

As the Court has long recognized, a second "principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortu-

nate debtor'" in the form of a discharge of the debtor's preexisting debts. *Marrama v. Citizens Bank*, 549 U.S. 365, 367 (2007) (citation omitted); *see also Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934) (quoting *Williams v. U.S. Fid. & Guar. Co.*, 236 U.S. 549, 554–55 (1915) (observing that the debtor's discharge is designed to "relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh")). As this Court has also observed, "[t]he discharge of the debtor has come to be an object of no less concern than the distribution of his property." *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555, 588 (1935). Indeed, as the Court explained in an early case under the Bankruptcy Act of 1898:

> The federal system of bankruptcy is designed not only to distribute the property of the debtor, not by law exempted, fairly and equally among his creditors, but as a main purpose of the act, intends to aid the unfortunate debtor by giving him a fresh start in life, free from debts, except of a certain character, after the property which he owned at the time of bankruptcy has been administered for the benefit of creditors. Our decisions lay great stress upon this feature of the law

Stellwagen v. Clum, 245 U.S. 605, 617 (1918).

Because the fresh start is so central and important to the administration of the bankruptcy system, it is unsurprising that the Court has held that procedures and exceptions that burden the debtor's discharge should be construed narrowly and likewise limited to those plainly expressed. *See Bullock v. BankChampaign, N.A.*, 133 S.Ct. 1754, 1760 (2013) (noting "the long-standing principle that exceptions to discharge should be confined to those plainly expressed") (citations omitted) (internal quotation marks omitted); *Kawaauhau v. Geiger*, 523 U.S. 57, 62 (1998); *see also Local Loan Co.*, 292 U.S. at 245 ("The various provisions of the Bankruptcy Act were adopted in the light of [the 'fresh start' policy] and are to be construed when reasonably possible in harmony with it so as to effectuate the general purpose and policy of the act.").

In this case, the bank plainly seeks to burden the debtor's discharge by preserving its payment leverage associated with its lien rights, even though its claim is wholly unsecured and the debt it represents is completely dischargeable—indeed, that is the whole point of its effort to avoid the application of section 506(d). To get around section 506(d), the bank relies on an exceedingly ambitious interpretation of the statute. The bank's interpretation, however, stands at odds with the principle that, unless plainly stat-

ed, ambitious constructions of the Code that burden the discharge are disfavored. Because the bank's construction is not plainly stated—indeed, it is not stated at all—it should be rejected.

3. The Bank's Approach Contravenes the Policy of Deleveraging Over-encumbered Assets.

Finally, a third relevant policy of the Code is the policy of disencumbering overleveraged assets. Several of the Code's provisions are specifically designed to remove encumbrances from the debtor's assets, such as liens and the like, so that these assets may be more readily deployed, either by the debtor or a purchaser. *See, e.g.*, 11 U.S.C. §§ 363(f) (providing for the sale of property free and clear of interests), 522(f) (providing for the removal of certain liens that impair the debtor's exemptions), 1123(a)(5)(D) (providing that a Chapter 11 plan may provide for the sale of the debtor's assets free of any lien). Section 506(d) is one of these provisions.

The policy behind the Code's encumbrance deleveraging provisions is straightforward. Assets that are over-encumbered with liens and the like are a burden to the debtor, creditors, the bankruptcy process, and the marketplace in general. For example, even if the debtor or trustee wishes to sell in bankruptcy an asset worth $1 million, no purchaser would pay anything for the

asset if it remained encumbered with $10 million in liens. To avoid this problem and permit the efficient sale of assets free of liens, Congress included with the Code section 363(f) cited above. Similarly, exempt property is worth less to the debtor if it remains encumbered with judicial liens and the like. To enhance the value of the debtor's exempt property, Congress included section 522(f) cited above. Section 506(d) has a similar office: to deleverage liens associated with unsecured claims as determined under the protocol established in section 506(a), regardless of whether the property is to be sold or retained by the debtor.

In this way, bankruptcy law aims to avoid state-law foreclosure procedures, and the reason for this is also straightforward: foreclosure liquidations typically realize lower prices and generate other problems. *See, e.g.*, *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994) ("[P]roperty that must be sold [through a state-law foreclosure procedure] is simply worth less" because "[n]o one would pay as much to own such property as he would pay to own real estate that could be sold at leisure and pursuant to normal marketing techniques." (emphasis omitted)). As one commentator has summarized: "[e]stimates suggest that a typical home loses something like half its value when it goes into foreclosure In addition, foreclosures disrupt lives, create neglected properties, and leave whole neighborhoods suffering." Alan S. Blinder,

After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead 321 (2013). For this reason, foreclosures are to be avoided. *Cf. United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) ("Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap'").

In this case, Caulkett wishes to retain his home and is willing to pay the senior lender more than it is worth to do so. This represents a value-maximizing transaction that has the effect of avoiding the foreclosure of the home and all of its attendant value-destroying consequences. Although Bank of America's lien is worthless, it still represents a form of leverage that the bank might use for its own financial gain, but its value to the bank lies solely in the costs the lien can impose on the debtor and the senior lender. Because preserving the lien is contrary to the policy behind the Code's deleveraging provisions, including section 506(d), the bank's interpretation of section 506(d) should be rejected.

CONCLUSION

For the foregoing reasons, as well as those briefed by Respondent, the decision of the court below should be AFFIRMED.

Respectfully submitted,

Arthur J. Gonzalez
Counsel of Record
NEW YORK UNIVERSITY SCHOOL OF LAW
40 Washington Square South, 314A
New York, NY 10012
(212) 998-6231
arthur.gonzalez@nyu.edu

February 24, 2015 *Counsel for Amicus Curiae*